is to create a condition of "competitive parity," by establishing a system of efficient comparative pricing ("ECP"). According to the witnesses, competitive parity is achieved if (1) BA-Md.'s own retail services are subject to the same wholesale charges that are imposed on MFS-I (except to the extent that the cost of providing those services differ), and (2) BA-Md.'s retail prices are set above its costs.

According to Professor Kahn and Dr. Taylor, an economically efficient charge to MFS-I for the wholesale services includes both the incremental cost to BA-Md. of providing interconnection and the amount of contribution that BA-Md. may lose when it loses retail customers to MFS-I. Moreover, BA-Md. asserts that the lost contribution that occurs when BA-Md. allows MFS-I to interconnect in order to take business customers is a very real opportunity cost of the decision to allow interconnection. BA-Md. further argues that any requirement that BA-Md. price interconnection without accounting for lost contribution would be a requirement that it provide below-cost services to its competitors.

According to witnesses Kahn and Taylor, since BA-Md. includes in its prices for business services substantial contribution to the shared and common costs of the network, the only way to achieve retail parity is for the same contribution to be collected from MFS-I. They said that, in this way, the focus of the competitive struggle between BA-Md. and MFS-I will be the retail services that both companies are offering, and that the consumer will reap the benefit of having those retail services provided at the lowest possible cost.

In order to develop an interconnection charge consistent with the Kahn/Taylor theory, BA-Md. witness Beard reviewed the cost studies recently performed in Case No. 8462 in order to determine to the extent possible, the direct incremental costs of providing local exchange telephone services to business exchange customers in Maryland.[7] Ms. Beard calculated that BA-Md. incurred direct incremental costs totaling $12.81 to provide business dial tone line, local usage, message telecommunications service (intra-LATA long distance) and intrastate access costs that BA-Md. concedes it would no longer incur if MFS-I provided these services to a former BA-Md. customer. Ms. Beard further calculated that, based on average business local messages per month, holding time per call, and unit access costs provided in Case No. 8462, BA-Md. would incur an average direct cost per line per month of $1.06 to terminate MFS-I calls on BA-Md.'s network.

Mr. Wallace took Ms. Beard's raw data and calculated the contribution that he assumes will be lost per business line from MFS-I's entry into the business local exchange market. Both Ms. Beard and Mr. Wallace based their analysis on the local exchange services (both dial tone and usage), plus intra-LATA toll and intrastate access. Not included in the analysis were

[7] According to Ms. Beard, direct incremental costs are costs that can be positively identified as being caused by the provision of a service. Ms. Beard differentiated direct incremental costs from shared costs (which are associated with a group or family of services, but cannot be directly associated with one specific service) and common costs (which are not related to the provision of an individual service or a particular group of services).

other services which are provided over the local dial tone line, such as vertical services. Based on the identified four services, Mr. Wallace calculated that BA-Md. received an average monthly revenue per business line of $46.70.[8] Subtracting the $12.81 in direct incremental costs for those services, Mr. Wallace calculated that BA-Md. would lose $33.89 per month in contribution for each business line served by MFS-I. Adding the $1.06 per month direct cost of terminating MFS-I calls on BA-Md.'s network, Mr. Wallace determined that the total cost of interconnection -- including both the contribution foregone (opportunity cost) and the direct cost of interconnection -- would be $34.95 per month.

From this data, Mr. Wallace proposes a revised switched access charge which is based on the currently effective switched access tariffs. Based on the length of the average business call, the access tariffs would reflect a charge of 6.1 cents per call. Mr. Wallace estimates that under this charge BA-Md., on average, would receive $20.48 per line from access charges from MFS-I monthly for completion of their local calls using BA-Md.'s network. Such revenues would reflect a substantial part of the contribution that BA-Md. claims is required from MFS-I for reasonable compensation for the interconnection service. The remainder of the contribution BA-Md. proposes to assess to MFS-I is in the form of a monthly CCC of $14.47.

[8] If vertical services were included in the calculation, Mr. Wallace maintains, BA-Md. realizes an average total monthly intrastate revenue of $70.81 per business line. BA-Md., therefore, is not seeking to recover the contribution it will lose from the additional $36.92 in monthly revenue per line.

Other parties take issue with the economic soundness of the Kahn/Taylor analysis, and particularly with how the theory is proposed to be applied under the facts and circumstances of this case.

MCI witness Cornell argues that BA-Md.'s proposed interconnection pricing would in effect act as a barrier to entry and deprive Maryland customers of the benefits competition brings. According to Ms. Cornell, BA-Md. would be guaranteed the same level of profits no matter how much of the market it is able to retain. Accordingly, Ms. Cornell asserts, one of the primary benefits of competition -- increased efficiency -- would be lost because guaranteeing profits to BA-Md. would remove any competitive pressures on the overall level of costs experienced by BA-Md. Any current inefficiencies that are now part of BA-Md.'s revenue requirement would not only remain but now become part of the burden on the entrant. For that reason, MCI urges the Commission to impose interconnection policies that will produce reasonable rates on non-discriminatory, reciprocal terms.

As noted above, MFS-I considers it reasonable that the interconnection rates that will be imposed for services received from BA-Md. should include a contribution to joint and common costs. However, MFS-I strongly objects to basing the contribution on the concept of ECP. Instead, MFS-I offers that the appropriate markup above incremental cost for interconnection services should be determined in the same way as markups for other bottleneck services. MFS-I suggests that this result can be achieved by using BA-Md.'s markup above incremental cost for such other services or its more competitive services as a benchmark for the allowable markup on bottleneck services. In this connection, MFS-I notes that Staff asserted that four cents would provide an appropriate markup above Bell's direct cost of terminating calls.

MFS-I also considers BA-Md.'s definition of "contribution" unreasonable. As applied by BA-Md., "contribution" constitutes the difference between revenues and direct costs. "Contribution," therefore means more than the recovery of joint and common costs; it includes BA-Md.'s profits. Furthermore, if BA-Md. gains a customer, the total difference between direct costs and revenues constitutes an increase in BA's profits. MFS-I argues that since contribution is defined as the total revenue from the service minus the direct (marginal) cost of providing that service, such an application of the Kahn/Taylor theory would guarantee that the entity controlling the facility to which interconnection is required is completely protected against any loss resulting from competitive entry. MFS-I reiterates the testimony of Dr. Cornell, namely, that BA-Md.'s earnings would remain constant, regardless of its skill, efficiency, and creativity in providing service in a competitive market. As such, MFS-I argues, BA-Md.'s approach is squarely contrary to the public interest in principle, and would also be inequitable and extremely impractical to administer.

Furthermore, MFS-I cautions that BA-Md.'s position on the recovery of lost contribution should not be confused with the arguments simultaneously advanced by BA-Md. that such a contribution is reasonable in light of BA-Md.'s obligation of providing universal service or of being the provider of last resort. MFS-I concedes that there are some costs, both direct and common, associated with these obligations, but that the amount of contribution BA-Md. asserts will need to be recovered has no particular logical or mathematical relationship to the cost of assuring universal service. MFS-I argues that the funding of universal service should be considered separately from the interconnection charges imposed on MFS-I, but notes that the costs properly attributable to universal service are only a small portion of BA-Md.'s common costs.

Staff and others assert that BA-Md.'s promise to reduce its CCC charges if and when it reduces its rates to end users is an empty gesture, because the ECP is designed to eliminate any incentive BA-Md. might have to reduce rates in response to competition.

As to economic efficiency arguments advanced by Professor Kahn and Dr. Taylor, MFS-I believes it knows why BA-Md. considers its application of the ECP model "efficient" from BA-Md.'s point of view: because it allows an incumbent to be indifferent to the entrance of competitors who depend upon it for interconnection to an essential input of production. If the incumbent's services are being sold at the profit-maximizing monopoly price, then ECP interconnection would allow the incumbent to continue collecting the same monopoly profits, even if the newcomer captured all customers.

MFS-I finds it more difficult, however, to see why ECP should be efficient or even rational from a public interest point of view. MFS-I disputes, particularly, that the public interest requires that BA-Md. continue earning its present level of profits, just because these profits were approved by the Commission in the last rate case as the amount needed by BA-Md. to be given the opportunity to earn a reasonable rate of return on equity. In this regard, MFS-I notes that it is generally recognized that the goal of a regulatory agency is to set rates at levels that produce approximately the profits that could be earned by a firm in a competitive market. If actual experience in a competitive marketplace demonstrates that the level of profits achievable by an efficient firm is different from the legal approximation adopted by the Commission, there is no economic justification for trying to maintain a higher, inefficient level of profits through manipulation of interconnection charges.

Beyond the general computation of the CCC, MFS-I takes particular issue with the fact that BA-Md. includes lost contribution from intra-LATA toll and switched access service. MFS-I notes that BA-Md.'s intra-LATA toll services have been open to competition for nearly a decade, and its switched access services have long been subject to "bypass" by interexchange carriers using dedicated connections to their end user customers. BA-Md. is not entitled to recover lost "contribution" from interexchange carriers when they compete against BA-Md. in toll and access services. Even if recovery of lost "contribution" from competitors could be justified on the grounds of economic efficiency and public policy, which MFS-I contends it has demonstrated is not the case, MFS-I maintains that there still would be no justification for singling out MFS-I alone for an interconnection charge that is not applicable to other entities competing with BA-Md for similar services.

Overall, MFS-I asserts, the ECP theory is plainly designed to prohibit competitive entry, efficient or not. MFS-I would consider this approach reasonable only if a regulator assumed that BA-Md 's monopoly was desirable, and then set interconnection prices so that (a) most likely no one would seek to enter the market and the monopoly would be preserved, or (b) if anyone did enter the market, the monopolist would be completely insulated from any economic impact. In such a case, MFS-I suggests it would be far simpler to prohibit competition outright than to adopt a system of contribution charges that would do the same thing indirectly.

As noted above, it is our aim to establish interconnection charges which are efficient and fair. In consideration of all evidence and arguments that have been presented in this proceeding, we conclude that, indeed, a competitive carrier should be required to make a contribution to that portion of the joint and common costs of the ubiquitous network that was heretofore provided by the local business service which the incumbent carrier will lose to competition. We do not agree with BA-Md.'s position, however, on the computation of what constitutes a reasonable contribution.

We are reminded by various parties of the precedent for a contribution charge which was embodied in the rates for interexchange access services which were established when BA-Md. lost all of its intrastate interLATA toll service. Both at the federal level and at the state level, when determining access charges, the regulatory agencies were cognizant of the initial need to carry forward the contribution to the local network which had been embodied in rates for toll services. At the federal level, such contributions were later mitigated by shifting cost recovery to the local network (as through the subscriber line charge); this was done, however, without depriving the local exchange company of the recovery of such joint and common costs.

While interexchange access rates may not constitute a precedent that is on point, Staff refers us to a decision by the FCC in Docket Nos. 91-141 and 92-222 dealing with rates for expanded interconnection and allocation of general support facilities costs. In that case, the FCC determined that all market participants should contribute to regulatorily mandated support flows reflected in the LEC's rates for services subject to competition. Although permitting the local exchange carriers to demonstrate the need for contribution charges, the FCC rejected the method for developing a contribution charge proposed by Professor Kahn, among others, which would allow the local exchange carriers to recover a contribution automatically in the amount equivalent to their special access and interconnection revenues minus their incremental cost of providing these services. The FCC concluded that such an approach would force interconnectors to bear a significant portion of overheads and would tend to result in an unduly high contribution element, unreasonably discouraging the use of expanded interconnection. Ultimately, the FCC found such an approach would reduce the consumer benefits of competition as an incentive for improved LEC efficiency and innovation. As to the fairness of such a decision, the FCC noted that the price cap system and other Commission rules would give the LECs an adequate opportunity to recover general overhead revenues lost when customers take service from an interconnector.

We recognize that this FCC decision necessarily constitutes no precedent in this case, both as to regulatory oversight and the nature of the services at question, although it does provide a methodology attractive to Staff, which urges us to adopt it. However, at a minimum, it expresses concerns that were raised by other parties, and concerns that we share, over the application of the Kahn/Taylor analysis as interpreted by BA-Md. in this case. In this connection, we note that while we do not operate under a Kahn/Taylor price-cap model of regulation for BA-Md., the flexible regulatory scheme and incentive rate of return, which we established in the current regulatory model, provide an opportunity for recovery of joint and common costs substantially similar to the plan put in place by the FCC.

It is with this information and background that we approach our decision on the issue of the need for a CCC and/or recovery of a contribution through the access charge. The Commission accepts the theoretical validity of allowing BA-Md. to recover a reasonable portion of contributions to overhead and common costs lost to local exchange competitors, much as we authorized the setting of intrastate access charges for long distance service at levels sufficient to retain at least some of the contribution lost when BA-Md. was foreclosed from inter-LATA service. Therefore we consider it in the public interest to ensure that the computation of such a charge is drawn in such a way as to insulate other basic rates from undue upward price pressure.

In this regard, we initially note that the local exchange access charge of 6.1 cents per call proposed by BA-Md. is based on the current level of intrastate interexchange access charges. As we noted above, the intrastate interexchange access charges reflect a substantial level of contribution. In fact, in this proceeding, some parties argue that the current intrastate interexchange access charges are priced unreasonably above cost. Therefore, these parties prefer a local termination charge of 4 cents per call or less. They argue that BA-Md.'s proposed 6.1 cents access charge should not be utilized.

We note that criticisms of current intrastate interexchange access charges are constantly advanced by interexchange carriers. However, this proceeding is not the appropriate forum for us to address the level of such charges.

As discussed above, we accept the principle that MFS-I is responsible for contributing a certain portion of BA-Md.'s costs of ensuring universal service. This record is insufficient to make a final determination of what that amount should be. At present, therefore, we will direct BA-Md. to file revised intrastate access tariffs that reflect charges for local exchange interconnection based on the 6.1 cents computation. We will accept these tariffs on a temporary basis, subject to further consideration in Phase II, if MFS-I is able to commence service as a co-carrier prior to the conclusion of Phase II.

As we noted above, such tariffs will satisfy about 60 percent of BA-Md.'s claim for contribution from MFS-I. In Phase II we will further investigate whether the contribution embedded in the 6.1 cents charge for local exchange interconnection is reasonable, and whether an additional mechanism for recovering lost contribution should be established, such as the CCC.

To give guidance to the parties in Phase II, the Commission believes that an appropriate amount of contribution from local exchange competitors is their fair share of the contribution needed to keep residential rates, and rural business rates, at levels necessary to allow for universal service. We are not persuaded that BA-Md.'s application of the Kahn/Taylor theory, which is aimed at efficient entry rather than determining any cost support necessary to maintain universal service, reasonably will achieve this goal, at least as presently applied by BA-Md. Instead, other avenues of determining the amount of contribution needed, and methods of collecting it, should be explored.

In this regard, for example, we note that BA-Md.'s present application of the Kahn/Taylor theory is based upon revenues currently received under rates that were accepted as reasonable in Case No. 8462. The Commission used a 1991 test year in that proceeding, however, which means that the ratemaking data underlying BA-Md.'s current proposal are becoming outdated. The Commission believes more current data would help us determine the amount of contribution needed by the various basic service classifications, and aid us in designing the appropriate amount of contribution to be provided by MFS-I and the method of collecting it.

We invite the parties to contribute to the investigation of the matter of the appropriate level of contribution to shared and common costs to be included in local access charges. Furthermore, in order to facilitate our review and determination, we direct BA-Md. to file with us in Phase II more current evidence on results of operations on a service category basis. In Phase II, the Commission anticipates examining DTL and usage costs of serving customers in the various service areas, and the revenues received for these services. In addition, the Commission will examine revenues from basic service customers for all other-than-competitive services, including the contribution from Yellow Pages.

In other words, the Commission is interested in determining in Phase II more precisely the extent of contribution that is needed to keep basic telephone service affordable for Maryland customers

L. **Local Number Portability**.

As mentioned above, co-carrier interconnection would result in the direct assignment to MFS-I of its own central office numbering prefixes (or "NXX codes"). As MFS-I explains, under the North American Numbering Plan telephone numbers are composed of an area code, a central office prefix, and a four-digit station number (e.g., in the Commission's telephone number of 410-767-8000, 410 is the area code, 767 is the central office code, and 8000 is the station number). The area code and central office code specify the LEC end office switch that serves the telephone number (e.g., all telephone numbers beginning with 410-767 are served by the same BA-Md. end office that serves the Commission.) LECs and IXCs across the United States use this information to route calls to the correct switching destination. As a result, under co-carrier interconnection, MFS-I would assign each of its customers a new telephone number using a central office prefix assigned to the MFS-I switch, rather than to a Bell switch.

It was undisputed that a requirement that customers change their telephone number as a condition of subscribing to a new carrier's services would be an impediment to competition. MFS-I described both short-term and long-term solutions to the issue of number portability. However, MFS-I proposes that the Commission only take action at this time on the short-term solution, and allow the parties to pursue other approaches through industry-wide fora and technical discussions. MFS-I requests, however, that the Commission should require BA-Md. and

MFS-I to cooperate in further study of these issues, and to report within 180 days a timetable for conducting technical trials of true number portability; if the carriers cannot agree on a schedule, the Commission should take further appropriate action.

MFS-I's modest short-term number portability proposal, which MFS-I maintains is entirely within the present ability of the Commission to authorize, is called Flexible Direct Inward Dialing ("Flex-DID"). Basically, it is a form of reseller interconnection. MFS-I would subscribe to BA-Md. DID trunks for the receipt of incoming calls to numbers that its customers desired to retain. This service would be identical to BA-Md.'s existing DID offerings, with the exception that any telephone number that a customer desired to switch to MFS-I could be designated as a DID number (the existing tariff only permits DID numbers to be assigned in consecutive groups of 20 numbers). BA-Md. agrees that, subject to appropriate technical trials, the Flex-DID proposal is technically feasible and can be provided. BA-Md. notes that this service should be provided from BA-Md.'s DID and PBX tariffs, and no unbundling of BA-Md.'s services should be required.

The Commission notes that local number portability is the subject of industry-wide discussions. Therefore, long-term technical solutions are likely to be found on a national basis, as opposed to the efforts of just two parties to this proceeding. Accordingly, while we do not oppose discussions on long-term solutions between MFS-I and BA-Md., the Commission also is reluctant to invest its resources in trying to resolve an issue that is currently being studied by many others possessing technical resources that outstrip our own. For this reason, the Commission does not order BA-Md. and MFS-I to embark on their own course of study, and does not require them to provide a timetable for their own technical trials.

The Commission does, however, direct those parties to keep us informed about advances that they or others may have made in devising a long-term solution to the technical aspects of true local number portability. Should such a solution become known during the Phase II proceedings, the parties may present it to us for our consideration. In the meantime, MFS-I is free to utilize Flex-DID, as described on the previous page, utilizing BA-Md.'s existing DID and PBX tariffs.

M. Regulation of BA-Md.

Although not opposing competitive entry, BA-Md. strongly believes that the Commission must make a change in the regulation of BA-Md. in response to the "cream-skimming" competitive entry that MFS-I proposes. Mr. D'Alessio describes the current regulatory sharing system in Maryland as requiring BA-Md. to cover its approved costs, including its shared and common costs and its authorized rate of return, by collecting contribution from averaged prices on other-than-competitive services in order to protect prices for residential dial tone service. Professor Kahn and Dr. Taylor find this system thoroughly inconsistent with unconstrained entry by competitors into the markets that the regulatory system has loaded with a disproportionate responsibility for the approved costs of the state-wide network. Therefore, if the Commission is going to allow MFS-I and others to provide competitive service, BA-Md. maintains, existing regulatory systems must be changed to recognize that the entrants will naturally go after the services and markets that provide the greatest contribution. That is where BA-Md. expects competitors most likely to be able to underprice, regardless of whether they can actually provide service more efficiently than BA-Md.

Mr. D'Alessio believes that there are two paths that regulatory change can follow. One is to allow a comprehensive rebalancing of BA-Md.'s rates to allow it to collect shared and common costs wherever the market will allow, without regard to the fact that this may cause residential and rural rates to rise substantially. BA-Md. does not believe that this path is feasible, because the practical requirement that the rebalancing minimize rate shock would so extend the transition that BA-Md. would remain vulnerable to serious damage from cream-skimming for years to come.

The second regulatory reform path would recognize both the practical requirement to protect large numbers of customers from such rate increases, and the need to preserve BA-Md.'s ability, as the provider of last resort of the state-wide infrastructure, to collect the shared and common costs of preserving and improving that infrastructure. This is the regulatory reform path that Mr. D'Alessio proposes: a price cap to protect residential dial tone service from the price increases that selective competitive entry into business markets would otherwise require, along with a set of interconnection pricing rules, including the Competitive Contribution Charge ("CCC"), to ensure that competition occurs on equitable and economically efficient terms.

According to Mr. D'Alessio, such terms would require the new entrant to bear the same costs to support the state-wide infrastructure that BA-Md. does, including the contribution that BA-Md. loses when a customer shifts to the new entrant. This rule, in BA-Md.'s view, would generate the more efficient -- and cost-effective -- telecommunications system for Maryland's consumers, because it results in the most efficient (lowest cost) provider serving the customer.

BA-Md. maintains that it is the Commission's task in this case to balance the benefits and burdens of emerging competition, both in the short term (by permitting competition to go forward in a manner that minimizes the risk to contribution), and in the long term (by implementing changes to Maryland's regulatory scheme that will permit Maryland to benefit from an increasingly competitive telecommunications marketplace).

BA-Md. asserts that evidence before the Commission supports BA-Md.'s position that the onset of local exchange competition requires a change in BA-Md.'s regulation from the present sharing/rate base/rate of return arrangement. BA-Md. makes a strong plea that price cap regulation is the most appropriate answer to the problem. It says that price caps will protect basic rates, eliminate the need for cost allocation by eliminating any incentive for BA-Md. to cross-subsidize its competitive services and provide vastly superior incentives to improve efficiency in the face of competition.

BA-Md. maintains that the historical practice of residually pricing basic telephone rates has maximized revenues from other service categories, such as business service, in order to minimize the cost increase in the basic service category. BA-Md. claims that the first benefit of a price cap regulation is the preservation of these basic rates. To the extent that the price cap system put in place contains a deflator based upon a presumed increase in productivity, basic rates will decrease annually by the productivity factor less increases in inflation.

As described by Mr. D'Alessio, BA-Md. favors a price cap system that incorporates a simple price cap for basic services for several years, to be followed by a cap that adjusts for some measure of inflation minus a reasonable measure of expected productivity gains. Pricing flexibility should be provided for discretionary and emerging competitive services. Included within the capped prices -- and thereby subject to reduction by a factor to be designated by the Commission -- would be charges to competitors, such as the Competitive Contribution Charge. If price caps were combined with the freedom to deaverage and flexibly price the services outside the price caps, the Commission would also ensure that competitive rivalry among BA-Md., MFS-I, and the other entrants would drive down BA-Md.'s costs for the services in contest, and thereby progressively reduce the size of the CCC that MFS-I and other entrants would pay.

In its Initial Brief, BA-Md. maintained that no party raised a substantive objection to the imposition of a price cap form of regulation. The Reply Briefs of some of the parties, however, dispute BA-Md.'s claim. Additionally, in recognition of the need for legislation for the Commission to be able to authorize price cap regulation, parties are concerned that waiting for price cap regulation will improperly delay MFS-I's application if regulatory changes are made a condition precedent to MFS-I's operations as a competitive local exchange carrier.

BA-Md. protests that that is not its intent. Consistent with the position put forth above, BA-Md. supports MFS-I's immediate entry as a reseller (but not as a co-carrier), and suggests that Phase II of this proceeding be used, in part, to develop the Commission's legislative initiative regarding price caps in advance of the General Assembly's 1995 legislative session.

We agree with Staff, MPC and other parties who argue that this is not the proceeding to put into effect any regulatory changes for BA-Md. However, in light of BA-Md.'s request, we find that the issue raised by BA-Md. warrants discussion.

The Commission has consistently taken the position that BA-Md. should be given the freedom to respond to competition wherever serious competition to services provided by this carrier develops. To that end, the Commission has divided the services provided by this carrier into so-called "competitive" and "other-than-competitive" categories. How competitive and OTC are defined, and at what point any service may be reclassified, are set forth in the Commission's orders.

The most recent proceeding for BA-Md.'s OTC services was Case No. 8462. In that proceeding, BA-Md. had proposed a continuation of the alternative regulatory plan at the expiration of the initial three-year period for another three years. Under the alternative regulatory plan that was most recently continued in Case No. 8462, the other-than-competitive rates were set at a level to provide BA-Md. sufficient annual revenues to cover the annual revenue requirements determined in that case based on the traditional expense rate base and rate of return formula. The statutorily prescribed determination of overall revenue requirements, however, in no way precludes pricing flexibility to be built into the regulatory regimen, provided that the overall incentive rate of return, as previously determined, remains within a reasonable range.

Under the decision in Case No. 8462, basic rates will remain unchanged (or capped) until 1996, unless otherwise ordered by the Commission, when the continuation or revision of the alternative regulatory plan will be reviewed. Although, in Case No. 8462, BA-Md. would have preferred to extend the present plan for another three years in 1996, the Commission found that re-examination at the end of the first three-year period would provide an opportunity to see whether further changes to the plan were appropriate especially in light of rapidly changing developments in the industry. The Commission anticipated that new services may be offered, with some of them falling into the OTC category. Additionally, services that formerly were monopoly offerings of the Company may now also be provided by other entities in competition with BA-Md. The Commission found that such changes may justify further adjustments in the structure of regulating services not yet fully competitive or further regulatory bifurcation from that presently in effect.

In view of BA-Md.'s request, it is appropriate to consider whether the current regimen should be aborted prior to the initial three-year period, or to what extent relief can be granted within the confines of the current regulatory plan. As we noted above, under Maryland's statutory provisions, rates have to be anchored in returns on investment. Unless these statutory requirements were amended by the Maryland General Assembly, a Kahn/Taylor model of price-cap regulation would not be consistent with the statutory requirements. However, if and when these requirements are amended by the Maryland General Assembly to permit price-cap regulation, BA-Md. would not be precluded from petitioning the Commission to institute a proceeding for further review of its regulation, even if this should occur prior to the expiration of the three-year effectiveness of the current alternative regulatory plan. However, pending any such action by the General Assembly and our receipt of a petition from BA-Md., we do not see any need to disturb the current regulatory plan which was put into effect by our 1993 decision in Case No. 8462. We do not view the currently effective regulatory plan as so distinct from price-cap regulation, or otherwise unfair to

BA-Md., as to require any remedial action by the Commission. The current plan provides considerable flexibility to BA-Md. to respond to competitive developments. Also, as indicated by BA-Md.'s quarterly financial reports, the company is able to achieve a rate of return which appears quite satisfactory relative to industry earnings.

As mentioned before, under current law rates need to be anchored in rate of return. In Case No. 8462, an incentive rate of return was established and a "sharing mechanism" between BA-Md. and its customers was established for earnings above the flexible range. A price-cap regulatory regimen, as noted by Professor Kahn, would eliminate any sharing obligation. In light of developments subsequent to the setting of revenue requirements in Case No. 8462, particularly certain accounting changes that have been authorized, it is not likely, in the short-term, that any substantial sharing will occur.

Although in Case No. 8462 OTC rates were capped, the Commission's decision left room for price adjustments under certain circumstances. For example, BA-Md. requested permission to ask for authority to restructure its intrastate access transport rates prior to the anticipated proceeding in 1996 in order to mirror changes which may occur at the interstate level. We suggested that BA-Md. make such a request at the appropriate time.

Furthermore, the Commission authorized BA-Md. to request that services which were becoming sufficiently competitive be moved out of the OTC designation if supported by sufficient evidence of competition.

BA-Md. does not suggest that it is timely to move any part of basic business services into the competitive column. Nor does Mr. D'Alessio suggest that at the present time, basic business services would not be subject to price caps when he suggests that price caps should be considered combined with the freedom to deaverage and flexibly price these services. However, by asserting that the competitive carrier would seek entry only where the averaged business rate supplies the highest contribution, the implication is that in order to be able to meet such competition, business rates need to be deaveraged.

The Commission has recognized in the past that the costs underlying dial tone differ with the density of subscribers. For that reason, dial tone rates are deaveraged by rate classes. At the present time, dial tone rates in Rate Class A (which is the most likely area where competition will first develop) are lower than dial tone rates in Rate Class B.

In Case No. 8462, the Commission considered whether rates should be further deaveraged by establishing a larger number of rate classes. Although Rate Class A and Rate Class B were further subdivided in A1 and A2 and B1 and B2, the changes were limited to a further deaveraging of the residential flat rate (usage) service. However, we do not prejudge future BA-Md. requests for further subdivision of the rate classes, in order to provide dial tone rates which more closely trace costs. While in testimony BA-Md. witnesses maintained that regulatory changes, such as deaveraging of rates, should be authorized concomitant with MFS-I's entry into the Maryland market, on brief BA-Md. seemed to drop pursuit of this course of action. On brief, BA-Md. abandons many of the arguments previously made, and concentrates on a big push for the Commission to seek authority from the General Assembly in its 1995 session to adopt a price cap regulatory scheme for BA-Md.

Under the circumstances of this case, however, any reclassification which may result in lowering rates for the sub-rate class could not be offset by increases to other subdivided rate classes, pending a general BA-Md. rate proceeding. Furthermore, any such rate revision would have to reflect the average joint and common costs which are assigned to that class of service.

While we do not prejudge any regulatory issue, the above discussion is intended to give guidance to BA-Md. and all parties with respect to our regulation of BA-Md. The evidence in this record does not persuade us that the authorization of MFS-I to compete with BA-Md. as a co-carrier necessitates any immediate change in the existing framework for regulating BA-Md.

However, the evidentiary record does persuade us that, in the future, it would be advisable for the Commission to have broader discretion to consider forms of regulation, other than the rate base/rate of return requirements, to set rates.[9]

[9] Indeed, although such was not discussed in the record in this proceeding, the Commission considers that it may be advisable to have the authority to consider other forms of rate setting not only with respect to telecommunications companies but also with respect to other industries and public service companies which are regulated under Md. Ann. Code art. 78.